LIFE INSURANCE AND THE DEMOCRATIC STATE

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LIFE INSURANCE AND THE DEMOCRATIC STATE

ONE OF THE most urgent tasks facing our country in these fateful days is the preservation of its democratic way of life in a world that is being consumed by the flames of war. The first world war was bolstered by the slogans that it was a war to make the world safe for democracy and a war to end war. The irony of these slogans is all too apparent today. We have learned through tragic experience that the method of war by its very nature tends to destroy the basis of democracy and to plant the seeds of future conflict. It remains to be seen whether we of this generation shall be able to profit by the terrible lessons of the past and shall have the spiritual insight and the intelligence to do those things which will make possible a different kind of world in the future. That today should be the paramount concern of each one of us.

Whatever the trend of events abroad, one thing is certain. Unless we in this country shall be able to make democracy function satisfactorily, some form of totalitarian government

will take its place. It is therefore of the utmost importance that, in our efforts to bring into being a better and a fairer world, we shall do everything possible to demonstrate to ourselves and to other nations that the democratic way enables us to attain high spiritual and material goals.

The word democracy is bandied about so glibly that it is frequently difficult to know just what it is intended to mean. Our own democratic system is based upon four essentials: (1) a written Constitution in which is included the Bill of Rights, (2) the selection through the medium of free elections of representatives to make the laws, (3) an executive to administer the laws, and (4) an independent system of courts created to see that the laws and their execution are within the provisions of the Constitution. This is the particular type of democracy, with its checks and balances, which we are seeking to maintain in this country.

Unfortunately, large numbers of people forget at times that under this kind of representative democratic government the making of laws is entrusted to a legislative body made up

of elected representatives who are freed from other duties and charged with the responsibility of studying the needs of the electorate and of enacting legislation to minister to those needs.

As a prelude to a discussion of the application of democratic principles in the field of life insurance, I would refer to the perversion of the democratic method illustrated by the notorious "Ham and Eggs" proposal with which you here in California entertained the rest of the country two years ago. The proposal, as you well know, involved the direct submission to the voters of an exceedingly complicated bill of some 7000 words which would have had the most far-reaching effects upon the political and economic organization of your state. It involved the central vote-catching proposal that every unemployed person aged 50 or over should receive $30 every Thursday. You defeated the bill by a gratifying majority, but only after a tremendous effort which you should not have been called upon to make. The job should have been done in Sacramento by legislators elected to study proposed laws and to act

upon them. Because "Ham and Eggs" was so fantastic it was defeated. However, in the concept that everyone in the community can pass intelligently and wisely upon any proposal, no matter how complicated or far-reaching, there lies a grave danger that irreparable damage may some day be done to the democratic system.

Another example of a misdirected conception of the working of democracy may be found in proposals sometimes made with respect to mutual life insurance companies. Here we have institutions to which have been entrusted large funds, held in what is closely akin to a trust capacity, which are administered for the benefit of the policyholders. There are no stockholders, the companies being owned by the policyholders and operated for their benefit.

In actual practice, the number of policyholders who exercise their right to vote, either in person or by proxy, at the annual meetings of their companies is usually small; and unfriendly critics therefore say that the mutual life insurance companies are mutual in name only.

At first glance, this assertion might appear to have merit. In a democracy, we like to think

that everyone exercises the right of franchise. Certainly we like all eligible voters to participate both in primary elections, where party candidates for political office are chosen, and in general elections, where the officeholders are finally elected. However, there is a very important difference between political office and a business. In political office, continuity in any position without periodic tests at the polls would be hurtful to the public interest because of the abuses that so easily could develop.

On the other hand, in a specialized business such as life insurance or banking, or for that matter almost any other business, or industry, continuity of management is not only an advantage, but pretty nearly a necessity. It is obvious that any system would be fraught with the gravest danger which in the name of democratic procedure should encourage large groups of policyholders to take the same sort of political interest in the election of directors of life insurance companies as in the election of legislators. The last thing you and I would want to do would be to entrust the future security of our loved ones to an institution whose directors

consisted of men who had campaigned actively among the policyholders for their positions. The same kind of problem would, of course, exist were the directors of banks, trust companies, or savings funds to be elected by hundreds of thousands of depositors.

To safeguard the interests of the public under a system of this kind, the several states have established departments headed by officials charged with the duty of supervising the operations of these fiduciary institutions. These men represent the public and stand ready to step in should abuses develop. Because of the safeguards provided by this supervisory system, the laws governing the elections of directors of mutual life insurance companies do not encourage the placing of rival slates of proposed directors before annual meetings of policyholders. They recognize the inherent dangers of any system which would not only encourage the self-seeking individual to run for office, but would make suitable men hesitate to accept nomination. In a very short time the sense of trusteeship that has characterized the conduct of mutual life insurance could be dangerously undermined.

It is because policyholders realize that their interests lie in preventing rather than encouraging political contests for control of management, that they rely upon the supervisory system and take but little interest in the annual meetings of the companies in which they are insured.

I would refer again to the position and power of the representatives of the public, the insurance commissioners. In the first place, a report in great detail concerning the operations of a company is made each year to the insurance commissioner of every state in which it does business. The commissioners are further empowered at any time to send examiners into any company under their jurisdiction to find out what is going on. Approximately every three years a group of examiners representing states from different parts of the country join with the examiners from a company's home state in making a thoroughgoing examination of companies doing an interstate business. It so happens that at this very time our own company in Philadelphia is having a regular triennial examination by a group of examiners representing Pennsylvania and three other states, one of

which is your own state of California. They have been there since the middle of January and are going into all phases of our operations.

Assuming that they should find something wrong which would indicate that a change in management would be in the interest of the policyholders, consider the power that would lie in the hands of our insurance commissioner. He could demand and obtain a list of all of our policyholders. To each he could send a request for a proxy at a meeting to elect directors, stating the reasons for his action. He would probably come to the meeting with proxies enough to elect a panel of directors to replace those whose terms were expiring. Considering the repercussions this action would have upon the public and the agency force of the company, it is clear that drastic changes in the management would be made. Thus would the sovereign power residing in the policyholders become effective to protect their interests. This is the supervisory technique that has been devised to safeguard the institution of mutual life insurance from the dangers inherent in active campaigns among policyholders for the election of

directors and at the same time to leave the ultimate power in the hands of the policyholders.

The Honorable Charles E. Hughes, Chief Justice of the United States, who conducted the well-remembered insurance investigation in 1905 and who has had wide experience in life insurance matters, commented upon the conduct of the life insurance business in 1926 when he was a private citizen. "It is well," he said, "that policyholders should have the opportunity to correct improper management, and their power though latent must be real; they must have the final control. But if they undertook to manage affairs directly, they would make a mess of it. How to obtain the safeguard of ultimate control by those whose interests are at stake, and the continuity and efficiency of expert management, without the intrusions and insincerities of politics or the fantasies of dreamers, that is the great problem. It has been solved to a gratifying degree in your case."

I have dwelt at some length upon this phase of the life insurance business for the reason that superficial critics are urging the adoption of a system under which large numbers of

policyholders would participate in the election of directors of mutual life insurance companies. These people are treading on dangerous ground. They would open the door to campaigns by self-seeking candidates for the position of directors on life insurance boards which would constitute a grave threat to the security of the policies of millions of policyholders. It would be as unsound and dangerous in the realm of life insurance practice as is the direct submission to the voters of such measures as your "Ham and Eggs" proposal.

Equally dangerous would be any plan by which political appointees should sit on life insurance boards. In due course such a program would be likely to jeopardize the interests of policyholders. All too frequently the objectives of politics and the security behind the policies of life insurance do not run parallel. Those persons who are charged with the conduct of fiduciary institutions such as life insurance companies, savings funds, banks, and trust companies must be kept free from political control if they are to fulfill the solemn obligations that devolve upon them.

Private enterprise and the preservation of democracy.—Before discussing the relation of life insurance to the democratic state, it will be helpful as a background to consider for a few moments the relation of private enterprise in general to the preservation of democracy. I have already referred to the system of checks and balances in our form of government, resting upon the principle that the legislative, executive, and judicial branches shall be independent and of equal rank. These conditions of independence and equality are absolutely essential if human freedom as guaranteed in the Bill of Rights is to be maintained. If, for example, the executive branch should ever be able to dominate the other two, the checks and balances would collapse and nothing would stand in the way of a President who aspired to dictatorial powers.

Although these three branches of government may appear at any given time to be independent of each other, it is of the utmost importance that we be alert to possible trends which might subtly undermine their independence and pave the way for disaster to ride in

from an unexpected quarter. The French believed themselves safe behind the most powerful line of fixed fortifications ever constructed. When the attack came they found that their line had been outflanked and rendered utterly worthless. Something analogous may destroy our own system of governmental checks and balances if we are not awake to possible dangers.

In a nation like ours, a very large proportion of the working population is engaged in private enterprise in the fields of industry, commerce, and finance. The system is not perfect, for it has to do with individuals motivated by all the impulses, good and bad, to which human beings are subject. However, one of the outstanding merits of the private-enterprise system is the fact that it makes it possible to maintain the essential checks and balances in our governmental organization. If the ownership and operation of our industrial, commercial, and financial system were not in private hands, they would be in the hands of persons and groups responsible to the political government and the checks and balances would be gravely endangered.

That is the reason why the trends in recent years have been so dangerous. They tend to break down the separation of economic and political power and to concentrate both in the hands of the politicians. First, there has been the indirect compulsion to vote for the party in power involved in the distribution of federal relief funds to large sections of the population. Second, there has been a tendency to accept the validity of the theory that the country's welfare requires that more and more control over industry, commerce, and finance should be centered in Washington. The power derived from the spending of federal relief money and other grants, although dangerous while it lasts, is likely to be temporary. On the other hand, that derived from a control by the politicians over the economic life of the nation should cause deep concern. It may spell the end of our democracy.

When the political government controls large areas of our economic life the setup is perfect for action by a Huey Long type of federal executive. All he would have to do would be to place in charge of strategic industries the type

of men who would compel workers to vote as they directed on pain of losing their jobs. The power over a man's means of livelihood is one of the most potent that can be conferred upon anyone. Once an executive can coerce enough votes to throw the balance of power upon his side, he can control the Congress. With control of Congress he can control the courts, since judges owe their positions to the executive and to the legislature. Hence, if the system of free, uncoerced elections should be undermined, the checks and balances would fall and no limits could be set to the power the dictator type of executive could exercise.

The ability to resist would, it goes without saying, be broken by some form of police force, secret or otherwise, which on one pretext or another would take dissenters in hand and disperse centers of opposition before they could organize.

All this sounds fantastic. Nevertheless, we have seen this kind of thing happen abroad in recent years and there is not the slightest doubt that if the centralization of economic power should continue far enough in the direction

it has been headed in Washington, the setup would be made to order for the advent of the dictator. In saying this we need not impugn the motives of those now in power. All we are saying is that we must take the greatest pains not to weaken the checks and balances which the founders of our Republic knew from the history of tyranny were necessary if human liberties were to be preserved. It has been well said: "The history of human freedom is the history of the limitation of governmental power."

It may not be amiss to point out that the absolute necessity of preserving a system of effective checks and balances is rooted deeply in human motives and behavior. If men were true Christians, guided solely by the Christian concept of life, the system under which we live could satisfactorily assume any one of many forms. Our troubles arise because men are selfish, revengeful, desirous of power, contemptuous of the rights of others. Unfortunately these traits of character are to be found in some members of all groups of people, whether they be those elected to public office, those engaged as employers in industrial and commercial life, or

those holding positions of power in the ranks of labor. Therefore, so long as these traits persist, we do away at grave peril with the checks and balances in our political and economic organization.

Herein lies the fatal defect in state socialism and other forms of collectivism. They concentrate enormous powers in the hands of individuals and do away with checks and balances. Because human nature is what it is, the system eventually blossoms forth into the cruel dictatorships that have grown up before our eyes in Russia and in Germany.

The supervision of life insurance.—Consideration of the centralization of power in the federal government leads readily to the subject of life insurance supervision for the reason that representatives of the Securities and Exchange Commission recommended about two months ago to the Temporary National Economic Committee that Washington be given power to participate in supervising the operations of life insurance companies.

As we have already noted, life insurance is at present subject to thoroughgoing supervision

by the several states. Over a period of seventy-five years this supervision has developed into a highly efficient system, which has been further strengthened as a result of experience gained during the unprecedented depression of the 1930's.

It rests upon a threefold base: first, the comprehensive system of state laws governing life insurance; second, the continuing supervision of the state insurance departments; and third, the National Association of Insurance Commissioners, which provides an opportunity for the interchange of information among the states and for the correlation of supervisory activities to the end that the system may operate smoothly and efficiently.

A most important feature of this coördinated system of state supervision is that its checks and balances provide a valuable safeguard to the interests of policyholders. These checks and balances are essential in a business, having to do with the financial security of tens of millions of persons, which might become subject to political influences. To a remarkable degree life insurance has been free from such influences,

and policy owners' interests have prospered accordingly. Where unwise action may have been taken by individual states, the error has been corrected or localized so that the harmful consequences have been reduced to a minimum.

The situation would be altogether different if supervision of the business were centered in the federal government at Washington. In that event we would face the probability of a political interference that could seriously endanger the security which policyholders now enjoy.

It must not be forgotten that life insurance policies concern the future welfare of millions of policyholders and their families. Certain benefits are promised in return for specified premiums. Large and absolutely necessary reserve funds are required by law to be accumulated, and adequate contingency funds must be maintained if the promises in the life insurance policies are to be fulfilled. This is a field in which the demagogue would find ample material upon which to base spurious proposals which, although appealing to the masses, would be utterly destructive of the long-run security behind life insurance contracts.

One of the great advantages of state supervision is that it is close to the people in the individual states and has an altogether different attitude toward them than would probably obtain if the local supervisory office were merely a branch of a huge central bureau in Washington. Another advantage is its flexibility and its ability to adapt itself to widely differing local needs.

An interesting example of this characteristic of state supervision occurred in 1933 when the closing of all the banks in the country caused thousands of policyholders to attempt to draw out the cash values of their life insurance policies. In consequence, the insurance commissioners of the various states coöperated in developing moratorium regulations which were in effect for several months over a large part of the country.

However, as the necessity for the regulations passed, the restrictions were lifted in those states where it was proper to do so, and policyholders residing there did not have to wait until the regulations could be lifted simultaneously throughout the entire country. It was

an excellent example of the benefits policyholders derive from the flexibility of state supervision.

In discussing state supervision I would of course not imply that it has been perfect or that it cannot be improved. As a matter of fact, improvement is taking place continually as need for it is shown. The point is that the interests of policy owners can be adequately safeguarded under the system of state supervision without running the very serious dangers inherent in centralized control.

The depression record of life insurance under state supervision is impressive. Despite the most severe and prolonged depression this country has ever experienced, we find that of the total assets held by life insurance companies at the beginning of the year 1930 only 2.1 per cent were in companies which during the seven years 1930 to 1936, inclusive, suffered an impairment of life insurance reserves calling for the appointment of receivers.

In this connection it must be borne in mind that as a general practice these companies were taken over and operated by established life in-

surance organizations. The policies remained in force but carried liens which represented impairment of the reserves of the original company. A substantial number of death claims were paid in full, in spite of the liens. It is an interesting fact that the total liens placed on all policies represented less than 1 per cent of the total assets of all life insurance companies in the country. Moreover, under good management the liens on many policies reduce until they finally disappear, so that policy values are fully restored.

It is clear, therefore, that, taking the institution of life insurance as a whole, the losses to policy owners as a result of the depression were very small. State supervision of insurance made an excellent record as compared with the results attained by supervisory bodies in other fields—notably the national banking field, where 2310 member banks of the federally supervised Federal Reserve System suspended payment during the four years 1930 to 1933. Furthermore, state supervision has been still further strengthened as a result of the lessons learned from the depression experience.

Of course the initial legislative proposals for federal supervision of life insurance would probably have the appearance of being reasonable and harmless. However, we must be alert to the future possibilities. Once federal supervision started, it would surely expand until, ten or twenty years hence, it would in all likelihood have supplanted state supervision and assumed full control itself.

Along with this control would ultimately go the control over life insurance investments. Washington would then be able to say whether the companies could or could not purchase the securities of this or that industry, thus giving to the bureau exercising this authority enormous power over the economic life of the country.

Moreover, there would be the constant danger that the control of life insurance investments would be a source of temptation to politicians who might have certain social or economic theories that could be carried into effect with policyholders' funds. For example, they might serve to provide a source of easy money for balancing the budget, or they might

be borrowed at the behest of pressure groups. If we would safeguard the institution of life insurance and its millions of policy owners, the first steps toward federal control must not be taken. Instead, attention should be directed to keeping the present system of state supervision, with its invaluable checks and balances, fully abreast of changing conditions.

Life insurance funds and venture capital.— Point is given to this analysis of the dangers inherent in possible federal control of life insurance by the recent report made by two representatives of the Securities and Exchange Commission to the Temporary National Economic Committee in which it is alleged that life insurance companies in their investment policies have sought security to such a degree that the savings of policyholders have not been flowing into new enterprises or undertakings where the element of venture or risk is present. This is one of the most amazing positions yet taken by responsible governmental representatives. It is tantamount to criticizing trustees who have sought security for the funds entrusted to their care and who therefore have

not made investments in new enterprises involving all the risks usually present in them.

A large proportion of you in this audience no doubt own life insurance policies. I wonder what your reaction would be if it should be announced that your company was about to curtail the investment of your funds in high-grade bonds and real estate mortgages, and was going to invest in the common stocks of new enterprises. My guess is that you would strenuously object. You know that the practice of conservative investment is the principal reason why the institution of life insurance made the enviable record it did during the great depression of the 1930's. It would have been tragic indeed had the companies in the 1920's invested any substantial proportion of their funds in common stocks. In this connection it may be mentioned that the laws of a number of important states, among them New York, do not permit such investments by their home companies. Some states do permit them to a greater or less degree, but despite this fact less than one-half of one per cent of all United States life insurance funds is invested in common stocks.

Returning now to the investments the life insurance companies have been making in recent years, let us look at the record of a group of companies having about 92 per cent of the total life insurance assets in the country. During the last five years their assets increased nearly 7 billion dollars. Since the increase in their uninvested cash balances during this period was only about 2 per cent of that sum, it is clear that the remaining 98 per cent did not lie idle. Looking over the list of investments, we find that the largest increase occurred in United States Government securities (2.87 billions). The second largest increase occurred in public utility bonds (1.90); the third in miscellaneous bonds, mostly industrial (0.89); the fourth in state, county, and municipal bonds (0.60), and the fifth in mortgage loans and real estate (0.52).* These five classifications account for practically the entire increase in total investments. There was a decrease in policy loans,

* In obtaining the figures for the changes in investments use was made of the estimates prepared in the latter part of 1940 by the Association of Life Insurance Presidents of the amounts invested in the various categories as of December 31, 1940.

offset by small increases in foreign government bonds, in railroad bonds, and in the uninvested cash balances above mentioned.

Reviewing this record of investments during the five-year period, it is evident that life insurance funds flowed into many channels and performed a useful function in maintaining our economic structure.

Incidentally, this is a convenient point at which to comment upon the statement sometimes made that a vast amount of control goes with the ownership of life insurance investments. It will be noted from the foregoing analysis that practically all the investments owned by life insurance companies are in the nature of obligations by corporate or individual borrowers, supported by pledge of valuable property, to make specific interest and principal payments. So long as these obligations are met the owner of the investment does not exercise control. It is not until default occurs that this follows, and then only as much control is exercised as is required to protect the interests of the policyholders whose money is at stake. The situation in its broad aspect is quite different

from what it would be if the life insurance companies should invest substantially in common stocks carrying voting rights. Then the charge of control would have substance.

Recognizing this difficulty, the representatives of the Securities and Exchange Commission who made the recommendations that the life insurance companies invest in common stocks suggested naïvely that the companies might be deprived of the right to vote their stock in the way other stockholders do. This is a curious suggestion. When a trustee becomes part owner of an enterprise, it would seem most unusual to prevent his having any voice in the management of the organization in which he has invested *other people's money*. No, the solution of the investment problems of the life insurance companies and of the country generally is not to be found in forcing trust funds into the stock of venture enterprise.

During the latter part of the 1920's there was agitation that the legal prohibition against investing policyholders' funds in common stocks should be removed. Fortunately, after careful consideration the step was not taken and the

disaster that life insurance policyholders might have incurred was avoided. I am convinced that once the policyholders of the country became aware that any attempt was seriously being made to force life insurance companies to invest their funds in the common stocks of new enterprises, they would have none of it.

This trend in the thinking in Washington becomes all the more ominous when coupled with the further suggestion made by representatives of the Securities and Exchange Commission that the federal government should take a hand in regulating life insurance. Any pressure, direct or indirect, to force life insurance funds into common stocks would be a dangerous threat to the security behind life insurance policies.

The subject we are discussing throws illuminating light upon the consequences of the faulty thinking which has resulted in the adoption of unsound policies in Washington. The persons who made the suggestions concerning the change in life insurance investment policy realized, as do many others, the necessity of having an adequate supply of risk capital for the

future development of the country's economic life. However, they ignored the crux of the problem and suggested an improper solution which might do irreparable damage to millions of people.

To find the reasons for the drying up of risk capital we must look to incorrect theories of taxation which either drive capital into the tax-exempt securities of state and local governments, or deprive business organizations and individuals of the opportunity to obtain a return from investment in venture enterprise that is both fair and adequate to compensate for the risk incurred. The solution of the problem of venture capital should be found by a change in unsound laws having to do with taxation, and not by asking trustees and others in a fiduciary position to invest the funds entrusted to their care in the risk capital of new business and industrial enterprise. Their function is to furnish senior capital. Junior or venture capital must come from other sources.

The proposal that life insurance funds be invested in common stocks, together with the suggestion that Washington should supervise

the life insurance companies, invites comment upon federal regulation in general. Such regulation is likely to commence in a very innocuous manner. However, as time goes on the regulating bureau assumes more and more authority, until finally it begins to assume the functions of management without at the same time being responsible for the final results.

If the enforced program is successful, the bureau is likely to take credit. If unsuccessful, the blame falls unfairly upon those persons who are responsible for the management of the enterprise that has been forced to adopt the unsound practices. This is one of the menacing characteristics of bureaucratic control. It constitutes a serious threat to the successful operation of the democratic system.

Finding outlets for life insurance funds.—A subject of much interest to all life insurance executives is the probable outlet for the future investment of the funds entrusted to their care. In considering it one is almost certain to run across theories which have emanated from high authority at various times in recent years, to the effect that this country has reached a state

of maturity and that in consequence the investment opportunities of the future will be severely limited. Saving or thrift is asserted to be no longer a virtue, but instead an economic sin. With the huge investment now required in connection with defense activities, this foolish doctrine, for the moment at least, is somewhat in eclipse. However, we are likely to hear more about it at some future date.

The theory of "oversaving," of a "mature economy," has a definite bearing upon the life insurance business for the reason that the continuing accumulation of life insurance reserve funds requires an adequate investment outlet if the business is to remain in a healthy condition.

One of the arguments advanced to support the "mature economy" thesis is that the frontier was closed about the beginning of this century so that there is no more good free or cheap land available for those who cannot find employment in the cities. This so-called "closed frontier" theory has served as a catch phrase upon which to hang a number of false conclusions. The basic trouble with the theory is that

the concentration of attention upon the agricultural frontier has made people ignore the development of what has been called the "industrial frontier," which in due course overshadowed in importance the old agricultural one based upon cheap land obtained from the government.

An exceedingly interesting analysis of this development has been made by Mr. R. S. Tucker, of the General Motors Corporation.* By painstaking study of census data covering the last one hundred years, he proved the great importance of the industrial frontier, which in reality provided an outlet for surplus rural population. The portion of the total population gainfully employed who were so employed in agriculture fell at a very steady rate from about 69 per cent in 1840 to less than one-third of that figure in 1930. Mr. Tucker's study leads, not to the conclusion that the agricultural frontier has been an essential to the country's progress; but rather that the opportunity for people to better their condition by moving to the city

* "The Frontier As an Outlet for Surplus Labor," *Southern Economic Journal*, October, 1940.

had been an important factor in maintaining the income of rural laborers, especially after 1890. This conclusion has been reached by other lines of reasoning, but it is interesting and helpful to have it supported by an analysis such as that made by Mr. Tucker.

This whole thesis of a "mature economy" is absurd when we consider the man power, the natural resources, and the capital that are available in the United States. Entirely apart from the huge demands for funds to finance the defense program, studies made by qualified individuals and organizations clearly reveal the need for the investment of billions upon billions of new capital in productive facilities and other durable goods, including housing, to provide for the country at large only a moderate increase in the average standard of living. The expenditure of these capital funds would enable large numbers of people to find employment. In the process they would earn the money with which to buy the products of our industrial and agricultural plant. The resulting favorable effects would be cumulative and would form the basis for a rising standard of living.

When peace returns, the way to achieve this objective will be found in the creation of conditions under which the reservoirs of private capital may be drawn upon and invested in capital improvements. To bring this about, action will have to be taken in the fields of taxation, labor relations, government controls of productive activity, government competition with private business, and budget policy.

During the impending period of intense defense activity we shall have no difficulty in finding employment for all available capital and labor. However, when we emerge on the other side we must profit from the lessons of the last twenty years and do those things which will make it possible to employ profitably our man power, our vast natural resources, and all the savings out of our income which we shall be willing to make through the medium of life insurance companies and other thrift institutions. The goal will be a higher standard of living extending down to the lowest income-earning groups. If we use our intelligence the possibilities for creating a better life for our 130 million people are very great indeed.

The S. E. C. study of life insurance.—About two months ago two members of the staff of the Securities and Exchange Commission made a report to the Temporary National Economic Committee, based upon a series of hearings relating to the institution of life insurance, held in Washington in 1939 and 1940. This report, consisting of 447 pages, contains a vast amount of material, only a small part of which I can now discuss.

The methods employed by the Securities and Exchange Commission in the conduct of the study provide an excellent example of the way in which a democratic government like ours should not treat one of its private institutions. Entirely too much of the study was based upon half truths, biased information, incorrect data, and the omission of facts which, if introduced, would have led to altogether different conclusions.

An illustration was the critical attitude taken toward the methods by which mutual life insurance company directors are elected. There was no reference to the basic philosophy underlying the conduct of mutual life insurance, to

the latent power of the insurance commissioners, or to the dangers of asking policyholders to choose between rival slates of candidates for the positions of directors.

Another was the treatment of the terminations or so-called "lapses" of life insurance. A man who had had no life insurance experience was employed by the Securities and Exchange Commission to analyze published records showing the ways in which life insurance policies are terminated. Some go out of force before the policies have acquired a cash surrender value, others are surrendered for their cash value, others become death claims or mature as endowments, and so on. As is true of all financial programs upon which people embark, a certain proportion fall by the wayside. This is shown in the termination rates of investments in building and loan shares, and in the repossession rates of automobiles, refrigerators, and other things bought on the installment plan. Human beings are prone to enter into desirable undertakings which they later find they cannot fulfill.

This is true with reference to life insurance.

People seeing the need for life insurance protection purchase policies which later they find they cannot maintain. As would be expected, life insurance terminations are high in periods of severe depression and low in periods of prosperity. In fact, the relationship between the two is very close. The deep depression of the 1930's took a heavy toll in life insurance terminations when great numbers of policyholders turned to the emergency values in their policies and either borrowed on them or surrendered them outright for cash. For many persons life insurance values were the only ones which stood up when financial structures were crashing in all directions.

Incidentally, it was the record of terminations during the exceedingly difficult decade 1928 to 1937 which was emphasized in the report made to the Temporary National Economic Committee. Millions of policyholders were compelled by economic conditions to give up their life insurance policies. To replace them the companies had to find new prospects with money enough to buy new insurance. Looking back upon that dark period, it is no

wonder that the outstanding life insurance in this country suffered a decline of 10 per cent from the peak. The loss has now been made up and the outstanding life insurance is at an all-time high.

Returning now to the witness of the Securities Exchange Commission above referred to, we find him using figures to reach conclusions that were far from the truth. He presented data showing over a period of years the proportions of policies which had terminated from various causes. From these data he incorrectly deduced that only a small fraction of policies taken out ever become claims by death. Not being familiar with the technical side of life insurance, he made an error which completely invalidated his conclusions. The error consisted in ignoring the probable future experience of the tremendous number of policies in force at the end of the period under review.

We can illustrate the error by referring to census data. Since in the 1930 census the average age of the population was found to be about 29 years, would it be sensible to conclude that this is the average length of life of people in this

country? Of course not, for the obvious reason that it takes no account of the future lifetime of those living at the time of the census. When correct methods are employed, it is found that the average length of life according to the 1930 census and the corresponding reports of deaths is about 59 years.

Because of the error in handling the life insurance data, the proportion of policies likely under average conditions to become claims by death is in reality about three times the figure incorrectly deduced by the witness from the data he had collected. When his testimony was given before the Temporary National Economic Committee, no opportunity was afforded the companies to question him or to offer testimony which would have corrected the error. His conclusions were given publicity, and naturally had standing because it would generally be assumed that they had been made by an impartial body using correct methods of analysis.

Competition in life insurance.—An interesting phase of the 447-page report by the two individuals above mentioned is a section showing

how varied are the costs of life insurance policies among the various companies and another section asserting that the companies had conferred together to fix rates and stifle competition.

Consider first the situation with reference to mutual life insurance. The companies charge rates of premium which provide a margin of safety and enable them to make yearly refunds to policyholders out of margins found by experience to have been unused. No one, of course, can foresee the future as far as mortality experience, interest earnings, and other contingencies are concerned, and for that reason it is impossible to know what the future cost of insurance is going to be. Complete data are available concerning what policies issued in the past have cost in any given company and what they would cost in the future *if* the current scale of refunds should continue unchanged. That is about as far as the average prospective purchaser goes in appraising the probable cost of a mutual life insurance policy.

The Securities and Exchange Commission made a study of twenty-six of the largest life

insurance companies, of which eighteen are mutuals. Although some charged the same gross premium for certain policies, no two companies had the same net costs to policyholders either on the basis of past experience or on the assumption that the basis for current refunds would be continued in the future. It is a bit difficult in this situation to find evidence of any effort to stifle competition in the life insurance part of the business of these mutual companies, which on the basis of premium income represents about 85 per cent of their total business.

A small group of stock companies, some of them issuing both participating policies and policies on which flat rates without refunds are charged, charged the same flat rates for certain policies. The new ordinary business of these companies, including both kinds of insurance, represents less than 10 per cent of the total new ordinary business being issued by the twenty-six companies. These stock companies are of course in direct competition with the mutual companies issuing the participating insurance already described. The fact that they charge the same flat rates is insignificant in a broad view

of the competitive situation in the field of life insurance costs.

In the field of group insurance a situation developed several years ago in which the supervisory authorities felt that it would be well to eliminate possible dangers through unsound competition in connection with the gross premiums charged for such insurance. It was felt that gross premiums should be adequate as far as security was concerned and that the competition should center on the net cost to the policyholders resulting from the payment of dividends or the adjustment of premiums based upon actual experience. Accordingly, this stabilization of gross premium rates was accomplished through intercompany conferences, the results of which were submitted to the supervisory authorities. The effect of the plan is to preserve the element of safety and at the same time to maintain keen competition in the selling of group insurance. If any employer desires to test the matter of competition, just let him publicize the fact that he is in the market for group insurance covering his employees. He will not have to wait long to discover that

among the companies issuing group insurance there is the most intense competition in the matter of costs and services rendered.

A considerable part of the assertion that conferences had been held by the companies to fix rates resulted from the fact that they had conferred on the subject of annuity premiums and those features of life insurance policies which provide for settlements guaranteeing interest rates and future annuity returns to beneficiaries. These conferences resulted from the problems created by falling interest rates and were essential to protect the interests of policyholders.

Take annuities as an example. They are usually sold for relatively large single premiums, which should be invested promptly. When the interest rates on new investments fall below the assumptions underlying the premium calculations, premium rates have to be increased. If some companies increase rates and others do not, the companies that lag behind have abnormally large sums of money poured in upon them for investment which may cause them heavy loss. Accordingly, where annuity rates

were being increased each company wanted to protect itself by not being left with low annuity rates when other companies were adopting higher ones.

The reason for the conferences therefore was to compare judgments with respect to the proper basis for annuity charges and to protect companies from the heavy losses that would be inflicted upon them if they lagged behind when the changes were being made by other companies. The results of the conferences were made known to the supervisory authorities, and there is no doubt that if they had not approved they would not have permitted the new rates to go into effect. Furthermore, because of the fact that companies which believed the new rates were too high were at liberty to continue to use lower rates and thereby to invite a land-office annuity business, the situation was in actuality self-regulating as against the charging of rates that were too high.

Owing to the fact that the conferences between companies were fully publicized and that all changes in rates or policy provisions resulting therefrom were submitted to the su-

pervisory authorities in the several states, the charge that there was collusion or other action not in the interest of the public is not valid. The treatment of the subject of intercompany conferences by the Securities and Exchange Commission was superficial and was presented in such a manner that it created a false impression.

In connection with the life insurance study, it was emphasized continually in Washington that it was concerned only with "facts," the inference being that it must therefore paint a true picture of what was going on. I am reminded of the story of a sea captain who, strange to say, had no use whatever for liquor. His first mate, however, was quite different; in fact was at times irritated by his captain's self-control. One day the mate was commissioned to write the log. After recording the routine items, he concluded the entry with this sentence: "The captain was sober all day." Factual, purely factual, but almost as misleading as a direct false statement.

Unfortunately, entirely too large a proportion of the study made by the Securities and

Exchange Commission was either incomplete or presented in so biased a manner that it gives an entirely false impression to the layman who thinks he is getting all the facts.

Because of the improper conclusions to be drawn from the record of the hearings, a group of life insurance companies—178 in number—filed a statement touching upon many of the subjects involved in the study. Although it was filed last August, the published 447-page report above mentioned makes no reference to the statement, despite the fact that this report is the one designed for reading by the public generally. The record of the hearings before the Temporary National Economic Committee does contain the statement, but it is to all intents and purposes lost to the general public in the 4000-odd pages covering the life insurance hearings.

It must be clear to all neutral observers that for an arm of our government to treat in this manner an institution with a record as favorable as that of the business of life insurance is both unfair and not in the democratic tradition. It smacks entirely too much of the

methods of autocratic government seeking to preserve the semblance but not the actuality of impartial investigation. The cause of democracy in our country will not be forwarded by such methods as these.

It should be made clear, of course, that no responsible person in the life insurance business would assert that improvements cannot be made in the way it is carried on. Like all other lines of business, it has difficult problems to solve. Earnest efforts are being made to solve them. A thorough study by a governmental agency seeking in a friendly manner to obtain all the facts in their true perspective could not but be helpful. Unfortunately, the good that might have resulted from the study made by the Securities and Exchange Commission has to a large extent been nullified by the omission of relevant facts which would have created an entirely different impression, by the atmosphere of apparent hostility frequently manifested, and by the feeling that the study was being used as a springboard for bringing life insurance under the control of the bureaucratic system in Washington.

Fortunately, the final report of the Temporary National Economic Committee, issued on March 31, creates a very different impression from that produced by the report and recommendations of the representatives of the Securities and Exchange Commission previously discussed. Specific recommendations are made for strengthening the state supervisory system. Three suggestions relating to possible ways in which the federal government might supplement state supervision in certain areas are made, but recommendations for federal regulation of life insurance are not approved. The situation, however, is one which will bear the most careful watching, as there seems to be little doubt that those who believe in a planned economy would like to have the federal government exercise control over the investment of life insurance funds. They may be counted upon to seek to achieve that objective by starting with apparently innocuous proposals which would get the nose of the Washington camel into the life insurance tent.

In conclusion.—In the midst of a world shaken by the mortal conflict of two opposing

philosophies of government and human liberty, we have been touching upon only one small segment of the whole picture. By reason of the stress and strain of the world conflict, this country is having to adopt more and more the principle of centralized direction from Washington. It is essential that we go no farther than is necessary in this direction and that the war emergency be not used as a pretext by those who at heart believe as a permanent policy in the regimentation of our economic life by Washington bureaus responsible to the political government.

The two suggestions coming from representatives of the Securities and Exchange Commission that functions of life insurance regulation should be assumed by the federal government and that policyholders' funds should be invested in the venture capital of new enterprise are the clearest kind of warning signals. Federal government control of the investment of life insurance funds would constitute an important step toward the bureaucratic control of all our economic life from Washington. If we are to succeed in the struggle to preserve

democracy and human liberty we do well not to break down through federal regulation the checks and balances that go with the time-tested system of insurance supervision by the individual states.